

RISKS OF OPTION WRITERS

1. An option writer may be assigned an exercise at any time during the period the option is exercisable. Starting with the day it is purchased, an American-style option is subject to being exercised by the option holder at any time until the option expires. This means that the option writer is subject to being assigned an exercise at any time after he has written the option until the option expires or until he has closed out his position in a closing transaction. By contrast, the writer of a European-style or capped option is subject to assignment only when the option is exercisable or, in the case of a capped option, when the automatic exercise value of the underlying interest hits the cap price.

An assigned writer may not receive notice of the assignment until one or more days after the assignment has been made by OCC. Once an exercise has been assigned to a writer, the writer may no longer close out the assigned position in a closing purchase transaction, whether or not he has received notice of the assignment. In that circumstance, an attempted closing purchase would be treated as an opening purchase transaction.

If an option that is exercisable is in the money, the option writer can anticipate that the option will be exercised, especially as expiration approaches. Once he is assigned an exercise, the assigned writer must deliver (in the case of a call) or purchase (in the case of a put) the underlying interest (or pay the cash settlement amount in the case of an in the money cash-settled option). The consequences of being assigned an exercise depend upon whether the writer of a call is covered or uncovered, as discussed below.

2. The writer of a covered call forgoes the opportunity to benefit from an increase in the value of the underlying interest above the option price, but continues to bear the risk of a decline in the value of the underlying interest. Unlike a holder of the underlying interest who has not written a call against it, the covered call writer has (in exchange for the premium) given up the opportunity to profit from an increase in the value of the underlying interest above the exercise price. If he is assigned an exercise, the net proceeds that he realizes from the sale of the underlying interest pursuant to the exercise could be substantially below its prevailing market price.